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No.

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1992

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MEDALLION OIL COMPANY, *et al.*,
*Petitioners*,

v.

TRANSAMERICAN NATURAL GAS CORPORATION, *et al.*,
*Respondents*.

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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## PETITION FOR WRIT OF CERTIORARI

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## QUESTION PRESENTED

Whether this Court, pursuant to its supervisory power as exercised in *Lehman Brothers v. Schein*, 416 U.S. 386 (1974), should reverse the lower court for refusing to certify an admittedly unresolved question of Texas law to the Supreme Court of Texas instead of deciding that question and thereby undermining the viability of all overriding royalty interests in Texas oil, gas and other minerals?

## PARTIES TO THE PROCEEDING

The following were parties to the proceeding in the court of appeals:

*Appellants*: Medallion Oil Company, H.S. Finkelstein, A. David Benjamin Finkelstein Irrevocable Trust, and Susan Raphael Finkelstein Irrevocable Trust.[1]

*Appellees*: GHR Energy Corp., f/k/a Good Hope Refineries, Inc., n/k/a TransAmerican Natural Gas Corporation, GHR Pipeline Corp., f/k/a Southern Pipe Line Corporation, n/k/a TransAmerican Pipeline Corporation, Southern States, Inc., Southern States Exploration, Inc., Laredo Exploration, Inc., Southern Petroleum Trading Company, Ltd., GHR Transmission Corp., f/k/a Southern Gas Transmission Company, n/k/a TransAmerican Gas Transmission Corporation, and JRS Realty, Inc.

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[1] Pursuant to Rule 29.1 of this Court's Rules, Medallion Oil Company states that it has no parent or subsidiary companies.

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Petitioners Medallion Oil Company, H.S. Finkelstein, A. David Benjamin Finkelstein Irrevocable Trust, and Susan Raphael Finkelstein Irrevocable Trust ask this Court to grant a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit.

## OPINIONS BELOW

The opinion of the Court of Appeals, App. A, *infra*, 1a-11a, is reported at 972 F.2d 96. The opinion of the Court of Appeals denying the petition for rehearing, App. B, *infra*,

12a-14a, is reported at 979 F.2d 40. The final judgment and order of the United States District Court for the Southern District of Texas, App. C, *infra*, 15a-16a, and the opinion of the Bankruptcy Court, App. D, *infra*, 17a-28a, are not reported.

## JURISDICTION

The judgment of the Court of Appeals was entered on August 27, 1992. A petition for rehearing was denied on November 24, 1992. App. B, *infra*, 12a-14a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## CONSTITUTIONAL PROVISION AND RULE INVOLVED

1. Article 5, § 3-c of the Texas Constitution provides:

> (a) The supreme court and the court of criminal appeals have jurisdiction to answer questions of state law certified from a federal appellate court.
>
> (b) The supreme court and the court of criminal appeals shall promulgate rules of procedure relating to the review of those questions.

2. Rule 114(a) of the Texas Rules of Appellate Procedure provides:

**Certification of Questions of Law.** The Supreme Court of Texas may answer questions of law certified to it by the Supreme Court of the United States or a Court of Appeals of the United States when requested by the certifying court, if there are involved in any proceedings before the certifying court questions of law of this state which may be determinative of the cause then pending and as to which it appears to the certifying court that there is no controlling precedent in the decisions of the Supreme Court of Texas. The Supreme Court may, in its discretion, decline to answer the questions certified to it.

## STATEMENT OF THE CASE

This case originated in federal bankruptcy court, but its outcome turns solely on the resolution of an unsettled question of Texas oil and gas law governing overriding royalty interests. Although it explicitly recognized that Texas law on this dispositive issue is unclear, the Court of Appeals refused to certify the state law question to the Texas Supreme Court for decision. Instead, the federal court proceeded to guess how the Texas courts would decide this question, and declared that Texas law permits the destruction of an overriding royalty interest in oil and gas by the conversion – without the royalty-interest owner's consent – of a lease, farmout, or other interest into a fee estate.

## Background

In 1974, petitioners Medallion Oil Company and H.S. Finkelstein ("Medallion") and a predecessor to respondent TransAmerican Natural Gas Corporation ("TransAmerican") agreed that Medallion would find oil and gas prospects for TransAmerican in exchange for a one-sixteenth (6.25%) overriding royalty interest from oil and gas production resulting from any mineral interests, whether leasehold, mineral fee or otherwise, acquired by TransAmerican by virtue of Medallion's efforts.

In 1975, TransAmerican and El Paso Natural Gas Company ("El Paso") entered into a "farmout" agreement under which El Paso granted TransAmerican the right to explore, drill and develop a natural gas field underlying the La Perla Ranch in south Texas and to produce and sell any natural gas that it found. TransAmerican began producing gas from the La Perla Ranch and has done so continuously since 1975. It is undisputed that the 1974 agreement between Medallion and TransAmerican applied to TransAmerican's interests in the La Perla Ranch and that TransAmerican paid Medallion royalties for gas produced from the La Perla Ranch.

In 1983, TransAmerican filed its second reorganization under Chapter 11 of the Bankruptcy Code. Medallion asserted substantial claims in that proceeding arising from its royalty rights for the La Perla Ranch and other properties. In 1987, Medallion and TransAmerican entered into a settlement agreement that ratified and confirmed the 1974 agreement as to the 6.25% royalty and granted Medallion a new and additional one and a half percent (1.5%) "settlement royalty" on production from all mineral

interests then owned by TransAmerican. In addition, TransAmerican agreed to pay Medallion $2.6 million for unpaid past royalties.

In 1990, in settlement of a dispute between TransAmerican and El Paso to which Medallion was not a party, El Paso conveyed to TransAmerican fee simple title to the La Perla Ranch mineral interests, and all other agreements between those two parties, including the earlier farmout and lease agreements, were terminated.

Thus, as of 1990, TransAmerican owned a fee interest in the La Perla Ranch minerals and continued to produce gas there. Even though TransAmerican owned a greater mineral interest than before, and even though TransAmerican continued exploiting its mineral interest by producing gas from the field, it claimed that termination of its farmout agreement with El Paso extinguished Medallion's overriding royalty.

**The Proceedings Below**

1. Medallion moved in the Bankruptcy Court to compel TransAmerican to continue paying royalties in compliance with the 1987 settlement and the 1974 agreement which that settlement had ratified. Both sides moved for summary judgment. Holding that Texas law was controlling, the Bankruptcy Court granted summary judgment for TransAmerican. Apps. D and E, *infra*, 17a-28a and 29a-30a.

In doing so, the Bankruptcy Court ignored the 1974 agreement and focused exclusively on the 1987 settlement agreement between Medallion and TransAmerican, as well

as the agreements between TransAmerican and El Paso establishing TransAmerican's interests in the La Perla Ranch minerals. The court construed the latter as containing a "surrender clause" permitting TransAmerican to give up its leasehold or farmout interests at any time. The Bankruptcy Court then concluded that, by converting its interests in the La Perla Ranch to a fee simple in 1990, TransAmerican had extinguished Medallion's overriding royalty. App. D, *infra*, 26a-28a. In so ruling, the court relied on a decision of the Texas Supreme Court, *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798 (Tex. 1967), which held that an overriding royalty interest expired where the underlying lease had expired and a new lease was not executed until a year or so later.[1]

The District Court affirmed the Bankruptcy Court's ruling without any independent analysis of the state law question. App. C, *infra*, 15a-16a.

2. Medallion's appeal was heard by a panel of the United States Court of Appeals for the Fifth Circuit consisting of two Circuit Judges from Mississippi and a Senior Circuit Judge from North Dakota, sitting by designation. The Court of Appeals affirmed the entry of

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[1] The Bankruptcy Court overlooked the fact that the 1987 agreement between Medallion and TransAmerican explicitly protected Medallion from the *Sunac* situation. That agreement provided that Medallion's overriding royalty

> shall also apply, extend to and include each and every renewal or extension of an oil and gas lease covered by this Assignment which is acquired by [TransAmerican], directly or indirectly, prior to or within one (1) year of the expiration or termination of said oil and gas lease.

App. A, *infra*, 6a.

summary judgment in favor of TransAmerican. App. A, *infra*, 1a-11a.

As it did in the Bankruptcy Court, Medallion argued in the Court of Appeals that its rights should be determined under the 1974 agreement, which guaranteed Medallion a 6.25% royalty in *any* mineral interest in the La Perla Ranch acquired at any time by TransAmerican. Under that agreement, Medallion would have been entitled to a 6.25% royalty interest in the gas produced from TransAmerican's 1990 fee simple interest and it would have been of no consequence that TransAmerican converted its prior farmout into a fee interest. The Court of Appeals rejected that argument, as well as Medallion's contention that an overriding royalty interest reserved in a lease is preserved by the principle of merger, if the lessee acquires title to the leased land. Had the Fifth Circuit ruled for Medallion on either of its primary arguments, there would have been no occasion for the Court to determine whether the *Sunac* case applied.

However, having rejected Medallion's two principal arguments, the Court of Appeals relied on *Sunac* by adopting the Bankruptcy Court's conclusion that, because of the "surrender clause" in the El Paso-TransAmerican form lease agreements, "Medallion's overriding royalties did not survive the termination of [TransAmerican's] leasehold estate and farmout agreement." App. A, *infra*, 9a. In doing so, the court rejected Medallion's argument, based on *Cain v. Neumann*, 316 S.W.2d 915 (Tex. Civ. App. 1958), as well

as a leading oil and gas treatise citing *Cain*,[2] that when gas production continues unabated, as it did here, an overriding royalty interest is not extinguished by the surrender of a leasehold interest, even in the face of an express surrender clause. App. A, *infra*, 9a-10a.

3. Medallion petitioned for rehearing, arguing that the Court of Appeals' decision was contrary to the decision of the Texas Court of Civil Appeals in *Cain v. Neumann*. In the alternative, Medallion requested that the Court of Appeals certify to the Texas Supreme Court the controlling question of whether a lessee can extinguish an overriding royalty by purporting to "surrender" the lease while continuing to produce in paying quantities from the very land which it covers.

In denying rehearing, App. B, *infra*, 12a-14a, the Court of Appeals conceded that Texas law on the question was unsettled: "We must admit . . . that neither *Sunac* nor *Cain* controls the case before us." *Id.* at 14a. Nevertheless, the court proceeded to apply *Sunac* because of what it regarded

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[2] *See* 5 Eugene Kuntz, *A Treatise on the Law of Oil and Gas* 227 (1991) (footnotes omitted; emphasis added):

> The overriding royalty is created out of an oil and gas lease and is necessarily limited in duration to the life of the lease. Accordingly, the overriding royalty will terminate upon expiration of the lease, upon termination of the lease for failure of the lessee to comply with the drilling clause, and upon a surrender of the lease by the lessee. . . . *If the lease is a producing lease, an attempt to surrender will be ineffective as to the holder of the overriding royalty.*[85]

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[85] *Cain v. Neumann* (Tex Civ App 1958), 316 SW(2d) 915, 9 O&GR 1173.

as two "dispositive" factors. *Id.* First, the court noted that the agreements between TransAmerican and El Paso contained an express surrender clause. But the court did not explain how this fact permitted it to reject Medallion's argument that *Cain* holds that an overriding royalty continues so long as production continues, even in the face of an express surrender clause. 316 S.W.2d at 919. Second, the court stated that there was no "hint of impropriety" in TransAmerican's dealings with El Paso. App. B, *infra*, 14a. In taking this position, the court did not explain how it could fault Medallion for failing to develop facts regarding TransAmerican's bona fides, nor did it reconcile its holding on reconsideration with its merits opinion that recognized "[s]ummary judgment is proper only if there is no genuine issue as to any material fact," so that "[i]n reviewing the evidence, we must view the facts and inferences in the light most favorable to Medallion." App. A, *infra*, 4a.

Having thus decided that *Sunac*, rather than *Cain*, provided the guide to decision in this case, the Court of Appeals, without more, denied Medallion's request to certify the controlling state law question to the Texas Supreme Court.[3]

## REASONS FOR GRANTING THE PETITION

The lower court in this case has decided an issue of enormous importance to thousands of Texas mineral-interest royalty owners. A three-judge panel – none of

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[3] This request was renewed in a motion to stay the mandate, which was also denied.

whom are from Texas – acknowledged that this case presents an issue that the Texas courts have not decided, but then proceeded to declare that under Texas law a royalty owner's rights can be destroyed simply by converting a lease into a fee simple.

Petitioners understand that this Court does not sit to review questions of state law, no matter what their significance. However, the Court's understandable unwillingness to exercise its certiorari jurisdiction for this purpose makes it all the more important that, from time to time, it remind the lower federal courts of their duty to certify important, unresolved questions of state law to state courts. The Court last did so in *Lehman Brothers v. Schein*, 416 U.S. 386 (1974), in the infancy of certification procedures, when it reversed a panel of non-Florida federal appellate judges for deciding a significant question of Florida law. In the nearly 20 years since *Schein*, while certification procedures have become widespread, the Court has not once spoken directly to the issue decided in that case. For two separate reasons, this case presents a suitable occasion for revisiting *Schein*:

First, the lower courts are badly in need of criteria to use in deciding certification questions, and, under any conceivable criteria, certification would be required here.

Second, the reasons given by the lower court for refusing to certify the Texas law issue in this case are so transparently flawed that even the abuse of discretion standard implied in *Schein* would lead to reversal here, thus providing a useful reminder that such a standard requires reasoned decisionmaking.

1. In *Schein*, a majority of the Second Circuit reinstated a complaint in a shareholder derivative action based on its prediction of how the Florida courts would decide an unsettled question of state law. *See* 416 U.S. at 389. On rehearing, the defendants for the first time requested that the court of appeals utilize the certification procedure, but the court denied rehearing and refused to certify. *See id.* at 392-93 (Rehnquist, J., concurring).[4] This Court held that the court of appeals should have certified the controlling state law question to the Florida Supreme Court. In so doing, the Court endorsed the certification procedure, stating that it "does, of course, in the long run save time, energy, and resources and helps build a cooperative judicial federalism." 416 U.S. at 391. Most commentators, including judges writing in law journals, have also favored broad use of the certification procedure, pointing to its utility in ensuring the proper allocation of decisionmaking authority between the state and federal courts.[5]

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[4] It is unclear from the *Schein* opinion why petitioners in that case delayed their request for certification until rehearing. In this case, however, two of petitioners' arguments in the Court of Appeals were based on the 1974 agreement and upon the merger of a leasehold or farmout interest into a fee and did not raise an issue requiring certification to the Texas courts. That issue was unavoidably raised only after the Court of Appeals in its merits opinion rejected those arguments and erroneously relied upon *Sunac* to decide this case. The Fifth Circuit has recently granted a request for certification on rehearing in closely analogous circumstances. *Frey v. Amoco Prod. Co.*, 951 F.2d 67 (5th Cir. 1992) (panel of Texas judges certifying Louisiana gas royalty issue to Louisiana Supreme Court).

[5] *See, e.g.*, Jon O. Newman, *Restructuring Federal Jurisdiction: Proposals to Preserve the Federal Judicial System*, 56 U. Chi. L. Rev. 761, 774 (1989); (continued...)

The Court in *Schein*, however, left an important question unanswered: Use of the certification procedure was said to rest "in the sound discretion of the federal court," *id.*, but this Court did not provide guidance on how that discretion should be exercised. *See, e.g., Complaint of McLinn*, 744 F.2d 677, 681 (9th Cir. 1984) (noting that *Schein* provides "no clear standards as to when certification should be used").

This Court has continued to certify state law questions since *Schein* either to avoid unnecessary adjudication of constitutional issues or to provide the requisite framework in which to apply constitutional standards. *See, e.g., Virginia v. American Booksellers Ass'n*, 484 U.S. 383 (1988); *Zant v. Stephens*, 456 U.S. 410 (1982); *Elkins v. Moreno*, 435 U.S. 647 (1978); *Belotti v. Baird*, 428 U.S. 132 (1976). However, in nearly 20 years the Court has not addressed the factors that ought to govern a federal court's use of the certification procedure to obtain a definitive determination of controlling issues of state law.

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[5] (...continued)
John R. Brown, *Certification — Federalism in Action*, 7 Cum. L. Rev. 455 (1977); John B. Corr & Ira P. Robbins, *Interjurisdictional Certification and Choice of Law*, 41 Vand. L. Rev. 411, 413 n.1 (1988) (noting that Chief Justice Rehnquist "recently described certification as 'a promising tool for obviating some of the great difficulties which result when a federal court attempts to interpret a state statute which has never been interpreted by the highest court of the state'"); Philip B. Kurland, *Toward a Co-operative Judicial Federalism: The Federal Court Abstention Doctrine*, 24 F.R.D. 481, 489-90 (1959); Note, *Inter-Jurisdictional Certification: Beyond Abstention Toward Cooperative Judicial Federalism*, 111 U. Pa. L. Rev. 344 (1963).

The absence of such standards has resulted in considerable disarray among the lower federal courts as to when certification should be used. For example, courts have taken opposing positions regarding certification of virtually identical state law questions. *Compare, e.g., Delahanty v. Hinckley*, 845 F.2d 1069 (D.C. Cir. 1988) (certifying question whether a plaintiff could assert a strict liability cause of action under state law against handgun manufacturers); *with Armijo v. Ex Cam, Inc.*, 843 F.2d 406 (10th Cir. 1988) (declining to certify similar question); and *Lucas v. United States*, 807 F.2d 414 (5th Cir. 1986) (certifying question whether state statute imposing damages ceiling in malpractice actions was valid under state constitution) *with Owen v. United* States, 935 F.2d 734 (5th Cir. 1991), *cert. denied*, 112 S. Ct. 870 (1992) (denying certification of similar question).[6] Given these disparate

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[6] There are many other instances where, although less directly in conflict, the federal courts appear to reach different results with regard to certification of state law questions. *Compare, e.g., In re Fingado*, 955 F.2d 31 (10th Cir. 1992) (certifying question of retroactivity of state statute), *with Lavespere v. Niagara Mach. & Tool Works, Inc.*, 920 F.2d 259 (5th Cir. 1990) (denying certification of retroactivity issue); *Bates v. Cook, Inc.*, 791 F.2d 1525 (11th Cir. 1986) (certifying issue regarding determination of choice-of-law question under state law), *with Perkins v. Clark Equipment Co.*, 823 F.2d 207 (8th Cir. 1987) (denying certification of choice-of-law issue); *Toner v. Lederle Lab.*, 779 F.2d 1429 (9th Cir. 1986) (certifying questions under tort law involving duties of pharmaceutical company) *with Polley v. Ciba-Geigy Corp.*, 658 F. Supp. 420 (D. Alaska 1987) (denying certification); and *Integrity Ins. Co. v. King Kutter, Inc.*, 866 F.2d 408 (11th Cir. 1989) (certifying issue involving insurer's duty to defend insured), *with National Cycle, Inc. v. Savoy Reinsurance Co.*, 938 F.2d 61 (7th Cir. 1991) (denying certification).

results, this Court should provide guidance to assist the courts of appeals in determining whether to certify.

That guidance is readily at hand: Shortly after *Schein*, the Fifth Circuit itself provided a useful list of factors, which were disregarded here, to be considered when determining whether to certify a question to state court. Of those factors

> [t]he most important are the closeness of the question and the existence of sufficient sources of state law – statutes, judicial decisions, attorney general's opinions – to allow a principled rather than conjectural conclusion. But also to be considered is the degree to which considerations of comity are relevant in light of the particular issue and case to be decided. [The court] must also take into account practical limitations of the certification process: significant delay and possible inability to frame the issue so as to produce a helpful response on the part of the state court.

*Florida ex rel. Shevin v. Exxon Corp.*, 526 F.2d 266, 274-75 (5th Cir.) (footnote omitted), *cert. denied sub nom. Standard Oil Co. v. Florida*, 420 U.S. 829 (1976). Because those factors would have led to certification below, this case provides the Court with an excellent vehicle in which to consider the adoption of guidelines similar to those articulated in *Shevin*.[7]

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[7] A federal court may certify questions to a state's highest court only if that state's law permits such certification. *Planned Parenthood Ass'n v. Ashcroft*, 462 U.S. 476, 493 n.21 (1983). Texas provides that a federal court of appeals may certify to the Texas Supreme Court a question "which may be determinative of the cause" and "as to which it appears . . .

(continued...)

First, the question of state law is a close one. Here, as in *Schein*, the Court of Appeals recognized that there was no controlling Texas precedent directly on point: it admitted that neither *Sunac* nor *Cain* was controlling. App. B, *infra*, 14a. Moreover, a leading treatise on oil and gas law relies on *Cain* to support the very contention made by petitioners below. *See* p. 8, n.2, *supra*. In these circumstances, the Court of Appeals' decision to follow *Sunac*, rather than *Cain*, and hold that Texas property law permits the destruction of overriding royalties although production continues was at best a "conjectural" decision. *Shevin*, 526 F.2d at 275.[8]

Second, considerations of comity militate heavily in favor of certification of the state law question. Here, none of the three members of the panel that decided the Texas law question was from Texas. In attempting to predict Texas property law, they, like the Second Circuit judges in

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[7] (...continued)
that there is no controlling precedent in the decisions of the Supreme Court of Texas." Tex. R. App. Proc. 114(a). In this respect, Texas is aligned with the law of most other states. *See* Dolores K. Sloviter, *A Federal Judge Views Diversity Jurisdiction*, 78 Va. L. Rev. 1671, 1684 (1992) (noting that 38 states have adopted a certification procedure by court rule or by statute).

[8] The dangers inherent in a federal court's prediction of how a state court would respond in uncharted legal waters are illustrated by the procedural history of *Schein*. *See Schein v. Chasen*, 519 F.2d 453, 454 (2d Cir. 1975), where the Second Circuit reversed its prior decision after receiving the opinion of the Florida Supreme Court. Numerous other instances of the inability of federal courts to predict state law are collected in Sloviter, *supra*, 78 Va. L. Rev. at 1679-81 & nn.48-53.

*Schein*, acted "as 'outsiders' lacking the common exposure to local law which comes from sitting in the jurisdiction." 416 U.S. at 391.

Third, the unsettled question of state oil and gas property law presented here is especially suited for decision by the state courts. As this Court noted in *Elkins v. Moreno*, 435 U.S. at 663 n.16:

> In a federal system, it is obviously desirable that questions of law which, like domicile, are both intensely local and immensely important to a wide spectrum of state government activities be decided in the first instance by state courts. This may not always be possible nor is it always required, but where as here there is an efficient method for obtaining a ruling from the highest court of a State we do not hesitate to avail ourselves of it.

Certification is particularly warranted here, in view of the complexity of oil and gas law generally and the frequency with which such questions arise in the Texas state courts.[9]

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[9] Both in its procedural posture and in the underlying issue of state law, this case is similar to *Thompson v. Magnolia Petroleum Co.*, 309 U.S. 478 (1940), which involved a dispute arising in a bankruptcy proceeding concerning the effect of fee-simple ownership on the right to drill for oil under a railroad right of way. This Court remanded the case with instructions to submit this state law question to the Illinois courts:

> [The] [d]ecision with which the federal court of bankruptcy is here faced calls for interpretation of instruments of conveyance in accordance with Illinois law. Neither statutes nor decisions of Illinois have been pointed to which are clearly applicable. . . . Unless the matter is referred to the state courts, upon subsequent decision by

(continued...)

Certification is all the more warranted here because the state law question affects thousands of holders of overriding royalties in Texas, as well as numerous other interested parties, including banks that have issued loans collateralized by overriding royalties. The decision effectively destroys the value as collateral of Texas royalty interests because under it they can easily be extinguished through restructuring of leases, farmouts or other interests into fee simple estates.

Finally, the "practical limitations of the certification process" identified in *Shevin*, *see* p. 14, *supra*, do not counsel against certification here. Delay is not a significant factor, since Texas permits certification of state law questions directly to the Texas Supreme Court. Furthermore, the state law question proposed by Medallion for certification was framed to produce a helpful response from the state court. Moreover, because other panels of the Fifth Circuit will be bound by the decision in this case, *see, e.g., Lee v. Frozen Food Express, Inc.*, 592 F.2d 271, 272 (5th Cir. 1979) (panel decision on state law issue "should be followed by other panels without regard to any alleged existing confusion in state law"), certification of the important issue decided below cannot await another similar bankruptcy or diversity case presenting it in federal court.

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[9] (...continued)
the Supreme Court of Illinois it may appear that rights in local property of parties to this proceeding have — by the accident of federal jurisdiction — been determined contrary to the law of the State, which in such matters is supreme.

*Id.* at 483-84. *See also*, *Leiter Minerals, Inc. v. United States*, 352 U.S. 220 (1957) (construction of state statute governing mineral rights).

2. Even if the Court were not inclined to formulate guidelines for the certification process, the Court of Appeals' refusal to certify in this case was an abuse of discretion and should be reversed.

Although it acknowledged that there was no controlling Texas precedent, the Court of Appeals nonetheless relied on two "dispositive" factors that led it to reject Medallion's arguments, instead of certifying this case to the Texas Supreme Court. Both factors are transparently flawed.

The court first pointed to an express surrender clause in the TransAmerican-El Paso agreement. In so doing, it simply ignored Medallion's argument that under *Cain v. Neumann* an overriding royalty continues so long as production continues, even in the face of an express surrender clause.

The court also noted that there was no evidence that TransAmerican "surrendered its interest in the lease to destroy the rights of the overriding royalty interest owner [*i.e.*, Medallion]." App. B, *infra*, 14a. But that observation merely begs the question whether a "surrender" of a lease while production continues *can*, under any circumstances, destroy royalty rights. If it *cannot*, as *Cain* holds, then the purpose with which it is done is of no consequence. Moreover, the Court of Appeals did not explain how, in a summary judgment context, Medallion could be faulted for the absence of facts regarding TransAmerican's intent. In this situation, the court's reliance on the lack of evidence on this issue was plainly erroneous.

Petitioners submit that, if the Court does not desire to establish criteria to guide federal courts' decisions whether

to certify state law questions to state court, it should use this case to remind the federal courts of the importance of the certification process by holding that abuses of discretion will be corrected. Should the Court choose the latter course, it may wish to consider summary disposition.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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February 1993

# APPENDICES

# APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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No. 91-6137

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In the Matter of: GHR ENERGY CORPORATION,
Debtor.

MEDALLION OIL COMPANY, *ET AL.*,
Appellants,

v.

TRANSAMERICAN NATURAL
GAS CORPORATION,
Appellee.

[August 27, 1992]

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Appeal from the United States District Court
for the Southern District of Texas

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Before BRIGHT,[1] JOLLY, and BARKSDALE, Circuit Judges.

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[1] Senior Circuit Judge of the Eighth Circuit, sitting by designation.

BRIGHT, Senior Circuit Judge:

This is a case concerning overriding royalty interests granted to Medallion Oil Company and H.S. Finkelstein [Medallion] on a leasehold estate under a farmout agreement between TransAmerican Natural Gas Corporation [TransAmerican] and El Paso Natural Gas Company [El Paso].

Medallion appeals the district court's affirmance of the bankruptcy court's grant of summary judgment, which determined that Medallion's overriding royalty interests in the La Perla Ranch leasehold estate did not survive the termination of the farmout agreement between TransAmerican and El Paso.

In this appeal, Medallion challenges the bankruptcy court's determination that: (1) Medallion's overriding royalties were extinguished by the termination of the underlying farmout agreement and leasehold interest; and (2) Medallion's overriding royalties did not increase commensurate with the increased interest acquired by TransAmerican in the La Perla Ranch. We affirm, but remand for reformation of the bankruptcy court's order.

## I. BACKGROUND

### A. Factual

In 1974, Medallion and Good Hope Refineries, Inc., TransAmerican's predecessor, entered into an agreement whereby TransAmerican would assign to Medallion a one-sixteenth overriding royalty interest in gas and oil production from mineral rights that Medallion would assist

TransAmerican in obtaining. In 1975, TransAmerican and El Paso entered into a farmout agreement, for the La Perla Ranch in Zapata County, Texas, under which El Paso granted TransAmerican the right to explore and develop the La Perla Ranch field and to obtain gas leases thereupon.

In 1983, TransAmerican filed Chapter 11 bankruptcy. In order to settle various disputes, TransAmerican and Medallion entered into a settlement [Medallion settlement] in 1987, which recognized a one-sixteenth overriding royalty for Medallion in the net revenues from La Perla Ranch under the 1975 farmout agreement. The settlement also granted Medallion a one and one-half percent overriding royalty on production from certain interests owned by TransAmerican, including the La Perla leasehold estate.

In 1990, TransAmerican and El Paso entered into a settlement [El Paso settlement] of a dispute over a gas purchase agreement that covered certain gas produced from La Perla Ranch. As part of the settlement, TransAmerican terminated all prior agreements between the two parties, including the 1975 farmout agreement and all leases thereunder, and El Paso assigned all of its mineral interest in La Perla Ranch to TransAmerican.

**B. Procedural**

This action arose during the course of TransAmerican's bankruptcy proceeding, when Medallion filed a motion to compel debtor's compliance with the Medallion settlement. In the motion to compel, Medallion alleged that TransAmerican owed it increased overriding royalties because TransAmerican had acquired the La Perla Ranch mineral

fee interest in the settlement with El Paso. TransAmerican countered with the argument that it owed Medallion no overriding royalties because the farmout agreement and leasehold interest, upon which Medallion's overriding royalties were based, had been terminated between TransAmerican and El Paso. Both sides filed motions for summary judgment. The bankruptcy court granted summary judgment in TransAmerican's favor and the district court affirmed its holding. This appeal followed.

## II. DISCUSSION

Our review of a district court's grant of summary judgment is plenary and we apply the same standard as the district court applied. *Lavespere v. Niagara Mach. & Tool Works, Inc.*, 910 F.2d 167, 177, *reh'g denied*, 920 F.2d 259 (5th Cir. 1990). Summary judgment is proper only if there is no genuine issue as to any material fact and TransAmerican is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c), *quoted in Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 2552, 91 L.Ed.2d 265 (1986). In reviewing the evidence, we must view the facts and inferences in the light most favorable to Medallion. *Lavespere*, 910 F.2d at 178.

On appeal, Medallion argues that the district court erred in holding that its overriding royalties were extinguished by the termination of the 1975 farmout agreement and underlying leasehold estate between TransAmerican and El Paso. First, it contends that when TransAmerican acquired the mineral fee rights, in effect, TransAmerican's leasehold interest merged with El Paso's reversionary interest. Thus, Medallion's overriding royalties in the leasehold could not be wiped out because the concept of merger should not

operate to destroy Medallion's interests. In support of its contentions, Medallion relies on portions of the settlement between Medallion and TransAmerican. As part of the settlement, TransAmerican

> agree[d] to assign and convey to [Medallion] an overriding royalty interest of one and one-half percent (1½%) of all oil, gas, other hydrocarbons, and all other minerals ... produced and saved from or attributed to the interests owned by [TransAmerican] ... as of April 23, 1987, at 12:01 a.m., in and to all ... "Leases," ... "Agreements" and [ ] all other interests in land ..., in each case covering or consisting of land situated in Webb and/or Zapata Counties, Texas, owned by [TransAmerican] ... as of April 23, 1987, at 12:01 a.m., and any increase in the quantity of interest therein owned by [TransAmerican] ... which is based upon any additional or greater interests therein received or realized by [TransAmerican] under reversions or other terms of any contracts or agreements in existence as of April 23, 1987, at 12:01 a.m. ....

Schedule A of the Supplement to Stipulation, at 1-2.

TransAmerican also agreed to

> convey to [Medallion] ... an overriding royalty interest equal to one-sixteenth (1/16th) of the net revenue interest earned, acquired or otherwise received, and to be earned, acquired or otherwise received, by [TransAmerican] ... under the said Agreement of March 18,

> 1975 [the farmout agreement], with El Paso, as supplemented and amended . . .

Assignment of Overriding Royalty, Attachment to Schedule B of the Supplement to Stipulation, at 4.

Both overriding royalties were subject to an extension and renewal provision, stating that the overriding royalty

> shall also apply, extend to and include each and every renewal or extension of an oil and gas lease covered by this Assignment which is acquired by [TransAmerican], directly or indirectly, prior to or within one (1) year of the expiration or termination of said oil and gas lease.

*Id.* at 7; Assignment of Overriding Royalty, Attachment to Schedule A of the Supplement to Stipulation, at 6.

Also, both of Medallion's overriding royalty interests were subject to the following clause, allowing TransAmerican to terminate at will any of its underlying interests:

> It is expressly agreed that operations, if any, on [the lands covered hereby], and the extent and duration thereof, as well as the preservation of such lease by rental payments or otherwise, shall be solely at the will of [TransAmerican].

*Id.*

Medallion's contention that the El Paso settlement resulted in a merger of the leasehold and reversionary interests is unpersuasive. TransAmerican terminated the leasehold estate and farmout agreement and acquired the

mineral fee estate, free and clear of the leases. No leasehold remained in existence, thus, there could be no merger.

"The term 'overriding royalty' has a well defined meaning in Texas. It is an interest which is carved out of, and constitutes a part of, the working interest created by an oil and gas lease." *Gruss v. Cummins*, 329 S.W.2d 496, 501 *writ ref nre* (Tex. Civ. App. 1959) (citations omitted). In the case at hand, TransAmerican agreed "to pay an overriding royalty, a certain share of the production, to [Medallion] as consideration for [its] services in procuring a lease on certain lands." 3 W.L. Summers, *The Law of Oil and Gas* § 554, at 625 (1958).

The bankruptcy court, in response to Medallion's claim that its overriding royalties continued beyond the termination of the underlying leasehold estate and farmout agreement, stated that:

> An overriding royalty interest, because it is carved out of a leasehold interest, is limited in duration to the leasehold interest's life, and the termination of that leasehold estate extinguishes the overriding royalty. *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 804 [*reh'g of cause overruled*] (Tex. 1967); *Keese v. Continental Pipe Line Co.*, 235 F.2d 386, 388 (5th Cir. 1956) (unless instrument creating overriding or royalty interest makes express provision to the contrary, the interest continues or ceases with the leasehold estate out of which it is carved and cannot survive termination by surrender or release of the leasehold estate by the owners).

> The plain language of the Medallion Settlement shows that Medallion's interest is not perpetuated should the farmout agreement terminate. Nothing in the Medallion Settlement provides that if TransAmerican acquires a fee interest in the La Perla Ranch properties, Medallion's overriding royalty interest would be redetermined to be a non-participating royalty interest applicable to the newly-acquired interest. In fact, the provisions relied upon by the Medallion Group provide that Medallion's overriding royalty interests relate only to TransAmerican's interests in effect as of April 23, 1987, at 12:01 a.m. As of that date, TransAmerican's working interest consisted solely of leasehold interests. Not until January 1, 1990, did TransAmerican's interest in the La Perla Ranch become a mineral fee interest. Moreover, the Medallion Group acknowledges in its Opposition to TransAmerican's Motion for Summary Judgment that its percentages were "carved out of TransAmerican's properties." [citation omitted] Thus, Medallion's overriding royalty interest, because it was carved out of TransAmerican's leasehold interest, was extinguished when TransAmerican's leasehold estate was terminated. *See Sunac* and *Keese*, *supra*.
>
> In addition, the Medallion Group expressly agreed that the preservation of any lease under the Farmout agreement was "solely at the will of [TransAmerican]." This language clearly and specifically allows TransAmerican to relinquish its obligation to pay the Medallion Group the 1½% and 1/16th overriding royalties by merely terminating the lease.

Mem. Op. dated May 14, 1991, at 11-12.

We agree with this reasoning and adopt the bankruptcy court's conclusion that Medallion's overriding royalties did not survive the termination of the leasehold estate and farmout agreement.

Second, Medallion argues that because gas production on La Perla Ranch continued unabated, TransAmerican could not surrender the leasehold interest and obliterate Medallion's overriding royalties. In support of this contention it quotes clause two of an oil and gas lease between El Paso and TransAmerican.

> 2. Subject to the other provisions herein contained, this lease shall remain in force and effect for so long thereafter as oil, gas, casinghead gasoline, or any of them is produced from the above-described lands or lands pooled therewith, or for so long as this lease is extended under any subsequent provision hereof.

Exh. B to Exh. D to Affidavit, Bankruptcy Record No. 9541.

In the case of *Fain & McGaha v. Biesel*, 331 S.W.2d 346, 347-48, *writ ref nre* (Tex. Civ. App. 1960), the Court of Civil Appeals of Texas held that, where the lease instrument authorized release of any part of the leasehold, the leaseholder could surrender a portion of the estate and terminate an outstanding overriding royalty interest. The court noted that although production of gas and oil on the leasehold never ceased, it did not "believe this would be material or operate as a distinction in any event." *Id.* at 347.

In the present case, clause twelve of the lease document expressly authorized TransAmerican to surrender the leasehold.

> 12. Lessee, its successors and assigns, shall have the right at any time to surrender this lease, in whole or in part, to Lessor or its successors and assigns by delivering or mailing a release thereof to the Lessor, and by placing a release thereof of record in the county in which said land is situated, thereupon, Lessee shall be relieved from all obligations, express or implied, of this agreement as to the acreage so surrendered.

Exh. B to Exh. D to Affidavit, Bankruptcy Record No. 9541.

The cases cited by Medallion in support of its position are inapposite because the leases therein did not allow the lessee to surrender the lease at will. Further, as noted above in the case at hand, TransAmerican's leasehold interest was to remain in effect so long as production continued, however, the term of the lease was subject to the operation of the other lease provisions, including clause twelve allowing surrender of the lease. Therefore, we hold that TransAmerican was free to terminate the leasehold estate, where the lease language expressly authorized the surrender, and to cut off Medallion's overriding royalties, despite the fact that gas production never ceased on the leasehold.

Finally, Medallion claims that TransAmerican owes it increased overriding royalties because TransAmerican expanded its interest by acquiring El Paso's entire La Perla Ranch mineral fee interest. We hold this argument to be without merit because Medallion's overriding royalty interests depended upon the continued existence of the leasehold estate and farmout agreement. The extension and renewal clause in the settlement agreement provided coverage for new or renewal leases acquired by

TransAmerican, not for fee interests. Also, Medallion failed to show that any contract in existence on April 23, 1987, entitled TransAmerican to receive the La Perla Ranch mineral fee in the El Paso settlement. In sum, the termination of the leasehold estate and the farmout agreement between TransAmerican and El Paso, with the consequent extinguishment of Medallion's overriding royalties, precludes Medallion's claim to an increased overriding royalty. The parties bargained for this result and we will not alter their bargain.

We AFFIRM the bankruptcy court's opinion and order, as adopted by the district court's judgment and order; however, we REMAND for reformation of the bankruptcy court's order to refine its coverage to exclude interests in the La Perla Ranch, which were not at issue in this case. In affirming, we note that, at oral argument, Medallion expressly disclaimed reliance upon equitable relief and chose to rely strictly upon the relevant contractual provisions.

AFFIRMED.[2]

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[2] Medallion's Motion for Extraordinary Relief is hereby denied as moot.

# APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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No. 91-6137

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In the Matter of: GHR ENERGY CORPORATION,
Debtor.

MEDALLION OIL COMPANY, *ET AL.*,
Appellants,

v.

TRANSAMERICAN NATURAL
GAS CORPORATION, Appellee.

[Filed November 24, 1992]

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Appeal from the United States District Court
for the Southern District of Texas

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ON PETITION FOR REHEARING

(Opinion August 27, 1992, 5th Cir. 1992, ___ F.2d __)
Before BRIGHT,* JOLLY, and BARKSDALE, Circuit Judges.

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* Senior Circuit Judge of the Eighth Circuit, sitting by designation.

PER CURIAM:

On petition for rehearing, Medallion Oil Company and H.S. Finkelstein ("Medallion") strenuously argue that this case is controlled by the Texas appeals court decision in *Cain v. Neumann*, 316 S.W. 915 (Tex. Civ. App. 1958). In *Cain*, a third party held an overriding royalty interest in a lease that by its own terms would continue as long as "oil, gas, or other minerals can be produced thereon." The lessor and lessee purported to terminate the original lease and enter into a new lease that would effectively eliminate the overriding royalty owner's interest. Nevertheless, production on the leased property never abated. The facts in *Cain* suggested that the defending parties intentionally harmed the overriding royalty interest owner for their own unjustifiable benefit. The court held that the parties had not terminated the original lease and that the overriding royalty interest survived.

Medallion has failed to convince us that *Cain* controls the instant case. After careful thought and review, we conclude that, as far as our case is concerned, the greater force of authority is found in the more recent Texas Supreme Court decision in *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798 (Tex. 1967). In *Sunac*, the lessee allowed a lease to terminate that was subject to an overriding royalty interest. After the old lease terminated, the lessee procured a new lease of the property. Noting that the original lease had a surrender clause that expressly allowed the lessee to terminate his interest in the lease property, the Texas Supreme Court found that the lessee had no obligation to maintain the lease. The supreme court also pointed out that this was not a "washout" transaction "involving some bad faith on the part of the lessee." *Id.* at 804. The Texas

Supreme Court then held that the new lease was not a continuation of the original lease and that the overriding royalty interest of the sublessee, as we have held here, did not survive.

We must admit, however, that neither *Sunac* nor *Cain* controls the case before us. We believe that two factors are dispositive of this case: First, in this case the 1987 agreement between Transamerican and El Paso contained an express surrender clause. By its own terms, the lease ended when Transamerican surrendered its interest to El Paso. That agreement governs this case. Second, Transamerican and El Paso entered into the new agreement because of the dispute between them. The new agreement had nothing to do with the Medallion-Transamerican relationship. There was not even a hint of impropriety on the part of Transamerican.

We might well reach a different result if the facts here had suggested that Transamerican surrendered its interest in the lease to destroy the rights of the overriding royalty interest owner.

We, therefore, DENY Medallion's petition for rehearing.

**DENIED.**

# APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| MEDALLION OIL COMPANY, | ) | |
| Appellant, | ) | |
| | ) | Civil Action |
| v. | ) | |
| | ) | No. H-91-1564 |
| TRANSAMERICAN NATURAL GAS CORPORATION, *et al.*, | ) | |
| Appellees. | ) | |

[Entered October 3, 1991]

**FINAL JUDGMENT AND ORDER**

This case is before the Court on appeal from the United States Bankruptcy Court for the Southern District of Texas. The Court has jurisdiction pursuant to 28 U.S.C. § 158(a). Medallion Oil Company ("Medallion") appeals the entry of summary judgment in favor of TransAmerican Natural Gas Corporation, based upon the bankruptcy court's determination that Medallion's overriding royalty interests in the La Perla Ranch properties terminated when the lease

agreements between TransAmerican and El Paso were cancelled. The parties filed cross motions for summary judgment, stipulating that there were no disputed issues of material fact. Therefore, the District Court in reviewing the bankruptcy court's decision must apply a de novo standard of review. *Matter of Consolidated Bancshares, Inc.*, 785 F.2d 1249, 1252 (5th Cir. 1986). The parties have submitted briefs, the Court has reviewed the pleadings, the record of the Bankruptcy Court, and the relevant case law, and the appeal is ripe for decision. The Court is in agreement with the well-reasoned decision of the Bankruptcy Court, and it is hereby

**ORDERED**

that the judgment of the United States Bankruptcy Court entered May 13, 1991 and May 14, 1991 is AFFIRMED for the reasons set forth in the Bankruptcy Court's Order Granting Summary Judgment.

THIS IS A FINAL ORDER.

SIGNED this 30th day of September, 1991.

/s/ J. De Anda
Chief Judge
United States District Court

# APPENDIX D

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| IN RE: | ) | |
| Transamerican Natural Gas Corporation f/k/a GHR Energy Corp. and Good Hope Refineries; Transamerican Pipeline Corporation, f/k/a GHR Pipeline Corp. and Southern Pipe Line Corporation; Southern States, Inc.; Southern States Exploration, Inc.; Laredo Exploration, Inc.; Southern Petroleum Trading Company, Ltd.; Transamerican Gas Transmission Corporation, f/k/a GHR Transmission Corp., Southern Gas Transmission Company, and JRS Realty, Inc., | ) | In Proceedings For Reorganization Under Chapter 11 of the Bankruptcy Code (Contested Matter) |
| | ) | Case Nos. 84-03474-H1-5 84-03475-H2-5 84-03476-H1-5 84-03477-H2-5 84-03478-H3-5 84-03479-H1-5 84-03480-H1-5 84-05539-H2-11 |
| | ) | PROCEDURALLY CONSOLIDATED |
| | ) | IN CASE NO. 84-03474-H1-5 |
| Debtors. | ) | |

## MEMORANDUM OPINION

### INTRODUCTION

H.S. Finkelstein and his affiliated entities, including the Medallion Oil Company, filed a Motion to Compel Debtor's Compliance with Settlement Order and a related Motion for Summary Judgment. TransAmerican Natural Gas Corporation filed its Motion for Summary Judgment. A hearing was held. After careful consideration of all pleadings, issues, memoranda, and affidavits, summary judgment is rendered in favor of TransAmerican.

The Medallion Group requests this Court by summary judgment to order TransAmerican to: (1) pay the Medallion Group interest on $367,000 from January 30, 1990 to April 12, 1990; (2) pay the proceeds attributable to TransAmerican's increased interest in the La Perla tract; (3) execute and deliver to the Medallion Group the Conference of Overriding Royalty Interests which documents Medallion's increased interest based on TransAmerican's acquisition of El Paso's mineral tract; and, (4) require the plan trustees to execute and deliver to the Medallion Group the Supplemental Subordination Agreement. The Medallion Group argues that the 1987 settlement agreement between it and TransAmerican provides for this.

TransAmerican in opposition requests summary judgment that Medallion is not entitled to any right, title or interest in any lands or interests in the La Perla Ranch properties, that it does not owe any interest or monies to Medallion, that Medallion is not entitled to any overriding royalty in any lands or interests conveyed by El Paso

Natural Gas to TransAmerican by virtue of the January 1, 1990 Mineral Deed and Bill of Sale.

Both sides want a dispositive ruling as to their disputes upon their respective motions for summary judgment without an evidentiary hearing.

## JURISDICTION

This Court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334.

## BACKGROUND

The La Perla Ranch is a natural gas field in South Texas operated by TransAmerican, and prior to this controversy, was owned by El Paso Natural Gas Company and others. In 1974, pursuant to a gas purchase agreement with TransAmerican, Finkelstein and the Medallion Oil Company received a 1/16th overriding royalty interest in the production from the field. In 1975, TransAmerican and El Paso entered into a joint operating and farmout agreement for development of the field. Under the El Paso farmout agreement, TransAmerican had the rights to acquire oil and gas leases from El Paso. The various dates are important.

During the 1980's, the relationship between TransAmerican and El Paso deteriorated. El Paso brought suit in state district court to set aside the gas purchase contract, and TransAmerican counterclaimed against El Paso alleging that El Paso committed numerous breaches of their gas purchase contract. After judgment was rendered in TransAmerican's favor, TransAmerican and El Paso entered into

a settlement. The El Paso Settlement became effective on January 1, 1990.

Pursuant to the El Paso Settlement, El Paso assigned all of its mineral interests in the La Perla Ranch Properties to TransAmerican under a Mineral Deed and Bill of Sale dated effective January 1, 1990. In addition, TransAmerican and El Paso canceled all duties, obligations, leases, agreements or claims arising from all prior agreements, including the farmout agreement, the gas purchase agreement, and the joint operating agreement.

Meanwhile in 1983, TransAmerican, then known as GHR Energy Corporation and Good Hope Refineries, filed Chapter 11 bankruptcy. Finkelstein and the Medallion Group filed claims in the TransAmerican bankruptcy to an additional royalty interest and accrued-unpaid royalties under the 1975 farmout agreement between TransAmerican and El Paso. In 1987 the bankruptcy claim between TransAmerican and Medallion was settled. The Medallion Settlement became effective on April 23, 1987, and was approved by this Court on May 16, 1987.

Pursuant to the Medallion Settlement, TransAmerican agreed to pay these claimants $2.6 million for past royalties allegedly owed but not paid. $367,000 of the settlement amount was to come from any recovery in the pending litigation against El Paso. As a result of the compromise between TransAmerican and the Medallion Group, a 1/16th overriding royalty interest was recognized for Finkelstein in TransAmerican's leasehold interest in the field earned under the farmout agreement. In addition, the settlement conveyed to Finkelstein a 1-1/2% royalty on the La Perla Ranch.

## SUMMARY JUDGMENT

Summary judgment motions in bankruptcy proceedings are governed by Federal Rule of Civil Procedure 56, as made applicable by Federal Rules of Bankruptcy Procedure 7056 and 9014. Rule 56 provides that summary judgment shall be granted if there is no genuine issue of material fact and that the moving party is entitled to judgment as a matter of law. Fed. R. Civ. P. 56(c). The movant bears the burden of showing an absence of genuine issues of material facts. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970). Summary judgment is warranted where the respondent fails to establish the existence of an element which is essential to the respondent's case and on which the respondent bears the burden of proof during the trial. *Celotex Corp. v. Catrett*, 477 U.S. 317, 322-23 (1986).

The respective motions for summary judgment are properly before this Court and are ripe for adjudication. The Medallion Group and TransAmerican came to this Court agreeing that there are no disputed issues of material facts. Transcript, July 6, 199[illegible] hearing on Motion to Compel, p. 12. Both sides request a ruling on their dispute through their motions for summary judgment. Neither side wants an evidentiary hearing. The disputes are all reducible to a problem of contract interpretation.

The Medallion Group relies on four contractual provisions in the Medallion Settlement to support its contention that its overriding royalty interests survived termination of the El Paso farmout agreement and joint operating agreement, to wit:

(1) Debtors hereby assign and convey to H.S. Finkelstein an overriding royalty interest of one and one-half percent (1-1/2%) of all oil, gas, other hydrocarbons, and all other minerals . . . produced and saved from or attributed to the interests owned by Debtors, or by any one or more of them, as of April 23, 1987, at 12:01 a.m., in and to all [Leases, Agreements and Other Interests], in each case covering or consisting of lands situated in Webb and/or Zapata Counties, Texas, owned by Debtors, or by any one or more of them, as of April 23, 1987, at 12:01 a.m., and any increase in the quantity of interest therein owned by Debtors, or by any one or more of them which is based upon any additional or greater interests therein received or realized by Debtors under revisions or other terms of any contracts or agreements in existence as of April 23, 1987, at 12:01 a.m. . . .

(2) In each tract covered by any of such Leases, Agreements or Other Interests in which there is an increase or decrease in Assignor's Working Interest or ownership in Subject Property covered by the Agreement or Other Interests after the Effective Date hereof, which increase or decrease occurs upon 'payout' or other point in time under agreement(s) in effect upon the Effective Date hereof, the Overriding Royalty Interest assigned and conveyed hereby to Assignee shall be increased or decreased proportionately in accordance with such increase or decrease in Assignor's Working Interest in such Lease or Leases or ownership in Subject Property covered by the Agreements or Other Interests, whichever is applicable.

(3) The one and one-half percent (1-1/2%) settlement royalty referred to in the above paragraph included, *inter alia*, TransAmerican's interest in acreage acquired under a certain Farmout Agreement dated May 18, 1985 between TransAmerican and El Paso for property located on the La Perla Ranch.

(4) An assignment of overriding royalty equal to one-sixteenth (1/16) of the net revenue interest earned by TransAmerican under the Farmout Agreement.

In addition, the Medallion Group relies on a provision in the El Paso Settlement in which TransAmerican represented and warranted as follows:

> Neither the execution and delivery of this Agreement and Operative Agreements, nor the consummation of the transactions contemplated hereby or thereby, will result in a breach of, or constitute a default . . . under, or otherwise give any person the right to terminate:
>
> * * * *
>
> (b) any lease, license, contract, or other agreement or instrument . . . to which TransAmerican is a party or by which it or any of its properties is bound or affected.

However, three other provisions of the Medallion Settlement are also important. First, the provision in the Medallion Settlement which sets forth the terms of the assignment of 1-1/2% overriding royalty interest states:

> It is expressly agreed that operations, if any, on the lands covered hereby, and the extent and duration thereof, as well as the preservation of the Leases, agreements or Other Interests covered hereby by rental or shut-in gas payments or otherwise, shall be solely at the will of Assignor [TransAmerican].

Under this provision, Medallion expressly agreed that TransAmerican was entitled to choose not to preserve the leases, agreements, or other interests from which Medallion's overriding royalty interests were carved.

Second, the provision which sets forth the terms of the assignment of the 1/16th overriding royalty interest states:

> It is expressly agreed that operations, if any, on said lands, and the extent and duration thereof, as well as the preservation of such lease by rental payments or otherwise, shall be solely at the will of Assignor [TransAmerican].

This provision's effect is analogous to the assignment of the 1-1/2% overriding royalty. Both the 1-1/2% royalty and the 1/16th royalty assigned to Medallion pursuant to the Medallion Settlement were subject to the critical limitation that TransAmerican could terminate the leases at will.

Finally, the Medallion Settlement provides that Medallion's overriding royalty was carved out of TransAmerican's working interest as of April 23, 1987, at 12:01 a.m. "Working interest" was defined as "the entire leasehold estate in and to each of such Leases as of April 13, 1987, at 12:01 a.m."

As a binding contractual Agreement, the interpretation of the Medallion Settlement is governed by Texas rules of contract construction. *See Butner v. United States*, 440 U.S. 48, 54-55 (1979); *Eastern Energy, Inc. v. Unico Oil & Gas*, 861 F.2d 1379, 1380 (5th Cir. 1988). A contract is construed in accordance with the plain meaning of its language unless it definitely appears from the writing as a whole that the intention of the parties would be defeated. *Great American Indemnity Co. v. Pepper*, 161 Tex. 263, 339 S.W.2d 660, 661 (Tex. 1960); *Fox v. Thoreson*, 398 S.W.2d 88, 92 (Tex. 1966). Moreover, if the contractual language is unambiguous, it is irrelevant that a party might have "meant" for that language to have a different meaning. *Alford v. Krum*, 671 S.W.2d 870, 872 (Tex. 1984).

**A. Interest Payment on $367,000**

Guided by these principles, it is clear that the Medallion Group is not entitled to interest on the $367,000 paid to it under the terms of the Medallion Settlement. The unambiguous language in the Medallion Settlement provides for the payment of two sums of money to the Medallion Group. These two payments are described in adjacent sentences as follows: (1) royalty payments for production in March and April 1987, with interest; and (2) one payment of $367,000 if TransAmerican prevailed in its then-pending suit against El Paso, with no provision made for interest.[1]

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[1] Paragraph 4 to the Supplement to Stipulation to Settle Pending Litigation in the Medallion Settlement provides:

> Since the commencement of these proceedings, the principal amount of $2,611,762 in overriding royalties

(continued...)

As evidenced by the expressed language of their contract, the Medallion Group clearly knew how to provide for interest payments. The Medallion Group cannot now claim that it "meant" to include interest on the $367,000 payment. *See Alford, supra.*

**B. Effect of TransAmerican's Increased Interest On The Medallion Group**

The Medallion Group is likewise precluded from receiving an increased interest due to TransAmerican's increased mineral interest in the La Perla Ranch properties. Medallion essentially argues that because the January 1, 1990 conveyances of the La Perla Ranch mineral fee interest from El Paso to Transamerican was in settlement of disputes arising under agreements in existence as of April 23, 1987, the Medallion Group's 1-1/2% interest in La Perla Ranch was increased along with TransAmerican's interest.

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[1] (...continued)

has accrued and is unpaid on the account of the Medallion claims in the Adversary Proceedings. Of this amount, approximately $74,000 (which includes payments accruing on production from March and April of 1987), plus interest accruing thereon, is held in escrow and shall be paid over to Medallion immediately upon approval of this Agreement by final, non-appealable order and dismissal of Adversary Proceeding No. 86-0292. Another $367,000 is due under Adversary Proceeding No. 85-0946-H2-5 if the Debtors prevail in their suit against El Paso Natural Gas for gas sold and delivered, and shall be paid to Medallion upon receipt by the Debtors of satisfaction of such an award from El Paso.

This Court does not agree. An overriding royalty interest, because it is carved out of a leasehold interest, is limited in duration to the leasehold interest's life, and the termination of that leasehold estate extinguishes the overriding royalty. *Sunac Petroleum Corp. v. Parkes*, 416 S.W.2d 798, 804 (Tex. 1967); *Keese v. Continental Pipe Line Co.*, 235 F.2d 386, 388 (5th Cir. 1956) (unless instrument creating overriding or royalty interest makes express provision to the contrary, the interest continues or ceases with the leasehold estate out of which it is carved and cannot survive termination by surrender or release of the leasehold estate by the owners).

The plain language of the Medallion Settlement shows that Medallion's interest is not perpetuated should the farmout agreement terminate. Nothing in the Medallion Settlement provides that if TransAmerican acquires a fee interest in the La Perla Ranch properties, Medallion's overriding royalty interest would be redetermined to be a non-participating royalty interest applicable to the newly acquired interest. In fact, the provisions relied upon by the Medallion Group provide that Medallion's overriding royalty interests relate only to TransAmerican's interests in effect as of April 23, 1987, at 12:01 a.m. As of that date, TransAmerican's working interest consisted solely of leasehold interests. Not until January 1, 1990, did TransAmerican's interest in the La Perla Ranch become a mineral fee interest. Moreover, the Medallion Group acknowledges in its Opposition to TransAmerican's Motion for Summary Judgment that its percentages were "carved out of TransAmerican's properties." Medallion Group's Opposition to TransAmerican's Motion for Summary Judgment at 5, fn.1. Thus, Medallion's overriding royalty interest, because it was carved out of TransAmerican's

leasehold interest, was extinguished when TransAmerican's leasehold estate was terminated. *See Sunac* and *Keese, supra.*

In addition, the Medallion Group expressly agreed that the preservation of any lease under the farmout agreement was "solely at the will of [TransAmerican]". This language clearly and specifically allows TransAmerican to relinquish its obligation to pay the Medallion Group the 1-1/2% and 1/16th overriding royalties by merely terminating the lease.

**C. Subordination of Liens**

Finally, because the Medallion Group is no longer entitled to overriding royalty interests on the La Perla Ranch properties, it is also not entitled to an agreement which affirms subordination of liens held by the plan trustees on the subject properties.

The provisions of the Medallion Settlement are clear and unambiguous. Thus, under Texas law, TransAmerican is entitled to summary judgment as a matter of law. The Medallion Group's Motion for Summary Judgment is accordingly denied.

A separate order shall be issued.

Dated this 14th day of May, 1991.

/s/
Manuel D. Leal
United States Bankruptcy Judge

# APPENDIX E

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

| | | |
|---|---|---|
| IN RE: | ) | |
| Transamerican Natural Gas Corporation f/k/a GHR Energy Corp. and Good Hope Refineries; Transamerican Pipeline Corporation, f/k/a GHR Pipeline Corp. and Southern Pipe Line Corporation; Southern States, Inc.; Southern States Exploration, Inc.; Laredo Exploration, Inc.; Southern Petroleum Trading Company, Ltd.; Transamerican Gas Transmission Corporation, f/k/a GHR Transmission Corp., Southern Gas Transmission Company, and JRS Realty, Inc., | ) | In Proceedings For Reorganization Under Chapter 11 of the Bankruptcy Code (Contested Matter) |
| | ) | Case Nos. 84-03474-H1-5 84-03475-H2-5 84-03476-H1-5 84-03477-H2-5 84-03478-H3-5 84-03479-H1-5 84-03480-H1-5 84-05539-H2-11 |
| | ) | PROCEDURALLY CONSOLIDATED |
| | ) | IN CASE NO. 84-03474-H1-5 |
| Debtors. | ) | |

[Entered May 14, 1991]

**ORDER**

The Medallion Group's Motion to Compel and their Motion for Summary Judgment are denied. Summary Judgment is granted in favor of TransAmerican Natural Gas Corporation that Medallion is not entitled to any right, title or interest in any lands or interests in the La Perla Ranch properties; that TransAmerican does not owe any interest or other monies to Medallion; that Medallion is not entitled to an overriding royalty in lands or interests conveyed by El Paso to TransAmerican by virtue of the Mineral Deed and Bill of Sale dated effective January 1, 1990; that Medallion is not entitled to any agreement affirming any subordination of liens held by the Trustees on the La Perla Ranch properties.

So ordered and adjudged.

Dated this 14th day of May, 1991.

/s/
Manuel D. Leal
United States Bankruptcy Judge